

Lessons from 2017

Disaster Recovery and Business Continuity Planning

With hurricanes, floods, wildfires and other natural disasters, the past year has offered plenty of lessons about the importance of being prepared for unexpected business disruptions.

Despite frequent reminders, many businesses remain unprepared for the unexpected. According to one major insurance company, 40 percent of businesses that don't have a disaster plan go out of business after a major loss such as a fire, break-in or storm.

For contractors and other construction-related businesses, disaster planning and preparation can be particularly challenging. You must consider not only your own facilities – trailers, shops, offices and IT systems – but also worksites where you share responsibility.

It's impossible to prepare for every possible type of business disruption. But it's important to have an effective disaster recovery and business continuity plan in place to help you minimize the financial damage and get back to business quickly.

There may also be legal reasons for developing such a plan. In many cases, a disaster recovery plan is required by a statute, contract or common law.

Identify the Risks and Their Effects

To develop or evaluate your disaster recovery or business continuity plans, begin with a business impact



analysis to identify the risks your company might encounter. These can include natural disasters, accidents, power outages, equipment or system failures, work stoppages and so forth.

Next, identify your critical business operations and systems and quantify the potential effect that each of these disruptions would have on them. Your goal is to develop a matrix that compares both the likelihood of certain events occurring and the amount of damage each event could cause.

Choose Your Strategies

Once your risks have been identi-

fied and prioritized, you're ready to choose from among the four traditional strategies for managing risk: avoid it, reduce it, transfer it or accept it.

In the case of natural disasters and similar threats, avoiding the risk altogether is generally not possible since it would probably require either moving or closing down completely. Accepting the risk is viable only for risks that are either highly unlikely (like a meteor strike) or relatively easy to recover from (like a traffic jam or minor rainstorm).

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The Changing Face of Construction

For many years when people spoke of modular construction, it was assumed they were talking about prefabricated houses. Today, however, modular or offsite construction techniques are reshaping projects of all types. This includes not just single-family residential projects but also commercial structures, roads and bridges, and public infrastructure projects.



The concept of using modular components fabricated elsewhere and assembled onsite has a long history in the construction industry. Pre-hung doors and preassembled windows have been used by homebuilders for generations, while tilt-up walls became commonplace in small commercial and retail projects years ago.

Also, restaurant, retail and hospitality franchises have long used prefabricated components to control costs and provide consistency in appearance and performance.

So prefabricating entire rooms or major structural components is not really revolutionary. Rather, it represents an evolutionary change – the logical next step as the scale and scope of modular construction continues to expand.

Modular Construction Advantages

One recent example of how far modular construction has come is the use of prefabricated components to replace aging bridges and other

infrastructure. The costs are not necessarily lower, but highway and heavy construction companies often can shorten the duration of road closures and reduce inconvenience to motorists. That feature has a strong appeal to the transportation officials who award contracts.

This illustrates one of the primary advantages of modular construction: It can help contractors accelerate project timelines. Instead of waiting for one trade to finish work before the next trade can start, modular construction allows various processes and sub-processes to be completed simultaneously, rather than sequentially.

The principle is the same as the “just-in-time” inventory techniques used in the auto industry and other manufacturing settings. The objective is for the various prefabricated components to arrive on-site just in time to link up with other systems.

When properly executed, offsite fabrication also offers the promise of better quality control since building systems and components are assembled under controlled conditions. This can help reduce weather-related delays and other complications while also enabling better safety controls.

Some modular proponents also point to prefabrication as a way to deal with the industry’s chronic labor shortage. Many construction employees find working in a controlled environment on a predictable schedule to be more appealing than working onsite in uncomfortable conditions.

Finding the Next Opportunities

Depending on the nature of your business and the markets you serve, it’s likely your company already engages in some level of offsite or modular construction. But more enterprising companies are going beyond the established modular

techniques and looking instead for new ways to take advantage of their potential benefits.

Here are three points to keep in mind as you seek to expand your use of offsite prefabrication:

- 1. Create opportunities** – Don’t wait for the perfect chance to use modular techniques. Best-in-class companies aren’t just willing to try new methods – they go out of their way to find excuses to use them.
- 2. Start early** – Think modular from the outset of the project. Whenever possible, begin collaborating with the architecture and engineering teams to identify modular construction opportunities while the project is still in the planning stages. The continued growth of three-dimensional building information modeling (BIM) techniques and other design-build tools can further encourage this.
- 3. Collaborate** – Work with manufacturers and other trades. Make connections with component manufacturers to think of new components to fabricate and better ways to combine them. Under the right circumstances, a joint venture (or even a less formal working arrangement) could pave the way for an important breakthrough.

Just as manufacturers work constantly to perfect their on-demand scheduling and just-in-time inventory practices, savvy contractors and subcontractors will continue to refine their offsite and modular construction capabilities. Being willing to experiment with new methods can help you stay ahead of the game – and give you a long-term competitive advantage.

Please call us if you would like to discuss this or other industry trends in more detail. We would be happy to meet with you.

Disaster Recovery Planning

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This leaves the remaining two strategies – reducing the risk through planning and preparation, or transferring some of the risk by insuring against damage or losses. For most threats, your strategy will be a combination of these two approaches, with a heavy emphasis on reducing the risk.

Protect People, Equipment and Data

With the strategies confirmed, it's time to examine your emergency procedures and identify the personnel and other resources you would need to restore critical systems. This can provide you with a list of action steps for launching or improving your recovery plan. (See sidebar at right for more details.)

Your objective is to protect three critical elements of your business:

- 1. Your people** – This should be your highest priority. Much of your recovery plan will focus on keeping your employees safe, informed and prepared. Recognizing this, some contractors have begun providing all employees with emergency supply kits to keep in their cars.
- 2. Your equipment** – This represents a sizable investment in most construction businesses. Review insurance binders and policy details on a regular basis (at least annually) to be sure they are current and reflect all current inventory.
- 3. Your business data** – This is especially critical in today's technology-driven construction industry. Bear in mind that natural disasters are only one category of risk that must be addressed. The loss of financial or project data due to power outages, system failures, viruses or cyber attacks can be almost as devastating as a physical loss.

As more companies move their data stores and operating systems

onto cloud servers, their vulnerability to a complete loss of data can be reduced. But moving to the cloud alone is not a panacea.

Work with your IT professionals to be sure you can access your backup systems and data quickly. The point is not only to preserve your data, but also to minimize the amount of time your business is down due to lack of data access.

Consult Experts for Help

When developing or upgrading your disaster recovery plans, it's important to work closely with those who have expertise. This includes your in-house IT team as well as IT consultants and specialized cybersecurity consultants.

Also talk to your insurance providers to obtain loss prevention expertise. After all, they have a vested interest in helping you minimize losses. They also can help you choose which risks you can insure against most cost effectively.

Be sure you are clear about policy terms and coverages. After Hurricane Harvey, many Houston-area businesses sustained no significant physical damage but were unable to operate because they were cut off by floodwaters. Unfortunately, some owners discovered too late that their business interruption insurance policies covered only losses stemming from actual physical damage to their premises – lack of access to the premises was not covered.

Many contracting businesses choose to work with professional disaster planning consultants to develop their recovery plans. While no one can prevent a disaster or foresee every possible risk, objective and experienced professionals can help your business plan for survival.

If you would like more information on business continuity planning, please call us for an appointment.



Disaster Recovery Plan Basics

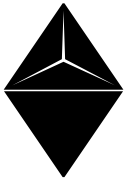
In the short term, a disaster recovery plan must identify and organize the individuals responsible for getting key business functions and systems operating again. Over the longer term, it must outline how you will return your company to its original capabilities.

Much of the emphasis in a disaster recovery plan involves designating teams to manage the various aspects of the effort to protect life and property and restore business operations. For example, your plan should spell out who will:

- Notify employees not to report for work or to report to different locations.
- See that critical data is retrieved from the cloud or an offsite backup.
- Communicate with clients and property owners during a crisis.
- Communicate with government officials and news media if necessary.

A disaster recovery plan should also include advance arrangements for a backup office location and secure offsite storage of paper documents such as employee records, contracts, financial and insurance records, and permits.

Even when your disaster recovery plan is updated and complete, you should review and revise it regularly. Performing an annual review is a good benchmark.



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Beall Barclay & Company, PLC | Certified Public Accountants
3101 South 70th Street, Fort Smith, AR 72903

Year-End Tax Planning? Remember the DPAD

Although it's been around since 2004, the Domestic Production Activities Deduction (DPAD) still causes occasional confusion among construction businesses.

Under Section 199 of the Internal Revenue Code, businesses can offset tax due on a portion of the income they generate from domestic production activities. This includes qualifying construction-related income.

To qualify for the DPAD, construction-related income must be generated by either the construction or substantial renovation of real property. The term "real property" includes buildings, structural components of buildings and other inherently permanent structures such as roads, bridges, and oil and gas wells. Some engineering, architectural and other services relat-

ed to qualifying projects may also be eligible for the DPAD.

Broadly speaking, most new construction projects in the U.S. would qualify for the DPAD, although there could be exceptions for some companies. On renovation projects, the answer is not always so clear-cut.

The critical question is whether the work amounts to a substantial renovation. If it does, it's typically eligible for the DPAD. But if it's classified as repair or maintenance work, it does not qualify.

A 2011 tax case helped clear up the DPAD a bit. The term "substantial renovation" is now construed as an activity that does at least one of three things: It materially increases the value of the property, substantially prolongs its useful life, or



adapts the property to a new or different use.

The DPAD is equal to 9 percent of the qualified income, or 50 percent of the W-2 wages that were paid in conjunction with the construction activity, whichever is less. The IRS considers Section 199 to be an issue of "high strategic importance," so be sure you have clear documentation to support your deduction.

Call us for help with any of your year-end tax planning or documentation questions.



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